HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: CS/HB 339 Motor Vehicle Service Agreement Companies
SPONSOR(S): White
TIED BILLS: **IDEN./SIM. BILLS:** SB 794

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	14 Y, 0 N, As CS	Lloyd	Luczynski
2) Commerce Committee			

SUMMARY ANALYSIS

Motor vehicle service agreement companies are one type of warranty association and are governed by the provisions in part I of ch. 634, F.S. Motor vehicle service agreements generally provide vehicle owners with protection when the manufacturer's warranty expires. Warranty associations are regulated by the Office of Insurance Regulation (OIR). The OIR's regulatory authority concerning warranty associations includes approval of forms, investigation of complaints, and monitoring of reserve requirements, among other duties. However, the OIR is not required to approve rates for warranties. Among other requirements, motor vehicle service agreement companies may meet statutory reserve requirements by purchasing contractual liability insurance from an admitted insurer. They can meet their reserve requirements by keeping a reserve equaling 50 percent of their gross unearned premium or purchasing insurance for 100 percent of their claims exposure. All existing casualty insurers in Florida are required to have $4,000,000 in surplus as regards policyholders.

Motor vehicle service agreements indemnify the agreement holder against loss caused by failure of any mechanical or other component part, or any mechanical or other component part of the motor vehicle that does not function as it was originally intended. The term "motor vehicle service agreement" also includes any contract that provides: for coverage which is issued in conjunction with an additive product applied to the motor vehicle that is the subject of such agreement; for payment of vehicle protection expenses (such as meeting applicable deductibles and providing for temporary replacement vehicle rental expenses); and for the payment for paintless dent-removal services. Either the company or the holder may cancel the agreement and, upon cancellation, specified refunds of premium must be issued to the holder.

A risk retention group is a corporation or limited liability association whose primary purpose is to share any or all of the liabilities of the members of the group. If they are organized under the law of any state or district of the United States, they may transact business in Florida. They may not exclude businesses from membership solely for competitive advantage. Membership in the group is limited to those engaged in business or activities that result in similar or related liabilities because of their similar, related or mutual business conditions. These groups may only be owned by their members or organizations owned by their members.

Risk retention groups can only insure certain risks. They are limited to liability insurance and reinsurance of other risk retention groups that share the same common interests required to form a group. The term "risk retention group" must be included in the group's name and they do not benefit from Florida's insurance insolvency guaranty funds.

The bill requires service agreement companies that purchase insurance to fund their reserve obligation to use an insurer with $15,000,000 minimum in surplus as regards policyholders. It allows service agreement companies to meet reserve requirements by participating in a risk retention group, if the group covers 100 percent of the claims exposure and maintains $15,000,000 minimum in surplus as regards policyholders. It removes a prohibition on companies that offer vehicle protection expenses from using an affiliated insurer to meet their reserve requirements. Lastly, lenders, finance companies, and creditors are given specific authority to cancel a service agreement in certain circumstances, if provided for in the agreement.

The bill does not appear to have a fiscal impact on state or local government.

The bill has an effective date of July 1, 2017.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Motor Vehicle Service Agreement Companies

Motor vehicle service agreement companies are one type of warranty association and are governed by the provisions in part I, ch. 634, F.S. Motor vehicle service agreements generally provide vehicle owners with protection when the manufacturer's warranty expires. While a warranty is not considered a traditional insurance product, it protects purchasers from future risks and associated costs. In Florida, warranty associations are regulated by the Office of Insurance Regulation (OIR). The OIR's regulatory authority concerning warranty associations includes approval of forms, investigation of complaints, and monitoring of reserve requirements, among other duties. However, the OIR is not required to approve rates for warranties.

Motor vehicle service agreements indemnify the agreement holder against loss caused by failure of any mechanical or other component part, or any mechanical or other component part of the motor vehicle that does not function as it was originally intended. The term "motor vehicle service agreement" also includes any contract that provides: for coverage which is issued in conjunction with an additive product applied to the motor vehicle that is the subject of such agreement; for payment of vehicle protection expenses (such as meeting applicable deductibles and providing for temporary replacement vehicle rental expenses); and for the payment for paintless dent-removal services.[1]

These companies are required to be licensed by the OIR prior to conducting business in Florida.[2] A company must meet the following conditions to qualify for licensure:[3]

- Be a solvent corporation,
- Prove to OIR that the management of the company is competent and trustworthy and can successfully and lawfully manage the company,
- Deposit $200,000 with the Department of Financial Services (DFS),[4]
- Have and maintain minimum net assets of at least $500,000, which must be kept in the United States,
- Keep and maintain an unearned premium reserve of at least 50 percent of the unearned gross written premium of each service agreement amortized pro rata over the life of the agreement, kept in a 10 to 1 ratio of gross written premium in force to net assets[5] (15% of this reserve must be deposited with the DFS),
    - This reserve is not required if the service agreement company holds a contractual liability policy and meets the following criteria:
        - The policy covers 100 percent of the claim exposure and is with an admitted insurer, [6]

[1] s. 634.011(8), F.S.
[2] s. 634.031, F.S. The unauthorized transaction of motor vehicle service agreements is a first degree misdemeanor punishable by up to one year in jail and a $1,000 fine. s. 634.031(7), F.S.
[3] s. 634.041, F.S.
[4] s. 634.052, F.S. If the company maintains less than $750,000 in unearned gross premium, the deposit may be lowered to $100,000. Also, the deposit may be lowered to no less than $100,000 after the first year of business upon application to the DFS for a release of a portion of the deposit. For good cause shown after notice and a hearing, the OIR may require the deposit to be increased to no more than $500,000 to protect the company's customers and creditors. The deposit must be in the form of the various securities specified in s. 625.52, F.S.
[5] This ratio only applies to the direct written premiums covered by the reserve, i.e., that are retained and not covered by contractual liability insurance held by the service agreement company. s. 634.041(8)(a)2., F.S.
[6] Contractual liability insurance is casualty insurance. s. 624.605(1)(b), F.S. Casualty insurers are required to initially have at least $5,000,000 in surplus as to policyholders and subsequently must maintain $4,000,000 in surplus as to policy holders. ss. 624.407 and 624.408, F.S.

    - If the service agreement company fails to meet its contractual obligations, the insurer is bound to cover all claims and refunds on agreements issued during the policy period, including those agreements that the company has yet to pay premium on,
    - If the service agreement is being fulfilled by the insurer and the company cancels the agreement, the insurer must issue the required pro rata refund (and representatives or agents must refund the commissions, pro rata),
    - There is a 90 day cancellation, termination, or non-renewal notice to OIR by the insurer, and
    - The company provides claim statistics to OIR.
- The service agreement company must be able to identify which allowed reserve requirement is being used to back each agreement. However, a company with at least $10,000,000 in assets and an audited actuarial statement on file with OIR is granted authority to manage blocks of new agreements under either of the two allowed forms of reserving, i.e., the 50 percent reserve or contractual liability insurance substitute,
- It must file, under oath of two executive officers, any information requested in writing by OIR regarding its transactions and affairs, and
- Limitations on reserve requirements apply to service agreement companies that provide vehicle protection expenses through their agreements, including a prohibition on purchasing insurance from an affiliated insurer.[7]

The OIR is prohibited from licensing a company if it has violated any requirement of part I of ch. 634, F.S., or any rules interpreting and implementing that part within the previous three years. There are 89 motor vehicle service agreement companies active in Florida.[8]

Motor vehicle service agreements are commonly purchased and financed at the same time as the vehicle that they cover. When the vehicle financing is satisfied, such as through sale, trade-in, or pay-off following an insured total loss, the service agreement should be cancelled to avoid unnecessary premiums and obtain a refund, as provided by law,[9] of the unearned portion of paid premium. While statute only references the action of the agreement holder regarding cancellations, the entity that financed the purchase of the vehicle and agreement may be the only one knowledgeable of the need to cancel the agreement in such circumstances. Acting on behalf of their customer, they request the cancellation.

Upon cancellation, the agreement holder is entitled to a refund of a portion of the premium paid.[10] The calculation of the refund amount changes based on the date of the cancellation. If the agreement holder cancels the agreement within 60 days after purchase, they must receive 100 percent of the gross premium paid, after deducting any paid claims and an administrative fee. The administrative fee is limited to 5 percent of the gross premium paid. If the agreement holder cancels the agreement more than 60 days after purchase, they are due a refund of 90 percent of the unearned premiums, after deduction of any claims paid. In this case, the refund is calculated proportionally to the future portion of the policy period being cancelled, i.e., pro rata.

[7] The service agreement company can use an affiliated insurer, if the insurer had issued them a policy prior to January 1, 2002. s. 634.041(11)(a), F.S.
[8] FLORIDA OFFICE OF INSURANCE REGULATION, ACTIVE COMPANY SEARCH, http://www.floir.com/CompanySearch/, Select "Motor Vehicle Service Agreement Company" under "Company Type" (last visited Feb. 17, 2017).
[9] s. 634.121(3), F.S. This section also governs cancellations by the service agreement company and provides detailed requirements concerning justification and process.
[10] "Unearned premium" means that portion of the gross written premium which has not been earned on a straight pro rata basis. s. 634.011(16), F.S. Premium is not earned until the policy period expires and are usually paid in advance. Unearned premium is that portion of a premium that the insurer has already received, but relates to future coverage during the policy period.

Risk Retention Groups

Risk retention groups are authorized under state and federal law.[11] Except for requirements related to oversight of the formation and operations of the group, regulation of these groups is preempted by federal law.[12]

A risk retention group is a corporation or limited liability association whose primary purpose is to share any or all of the liabilities of the members of the group. If they are organized under the law of any state or district of the United States, they may transact business in Florida.[13] They may not exclude businesses from membership solely for competitive advantage. The group must be solely owned by either:

- its members who receive insurance from the group, or
- by an organization whose members are the members of the group; however, the owning organization must be owned by those making up and receiving insurance from the group.

The group members must be engaged in business or activities that result in similar or related liabilities because of their similar, related or mutual business conditions.

Risk retention groups can only insure certain risks. They are limited to liability insurance and reinsurance of other risk retention groups that share the same common interests required to form a group. The term "risk retention group" must be included in the group's name. None of Florida's insurance insolvency guaranty funds are available for risk retention group insolvencies. There are 108 risk retention groups active in Florida.[14]

By forming or joining a risk retention group, a prospective member, such as a motor vehicle service agreement company, can take advantage of economic opportunities consistent with self-insurance. They may be able to save money by controlling overhead costs and limiting profits that cannot be avoided through the purchase of insurance. As members, they maintain or participate in the control of assets and investments dedicated to the reserves that will fund claims exposure. The availability of participation in risk retention groups provide business with another option to compete in the market and take advantage of economic opportunities.

Effect of the Bill

The bill:

- Requires service agreement companies that purchase insurance to fund their reserve obligation to use an insurer with $15,000,000 minimum in surplus as regards policyholders. This increases the minimum surplus as to policyholders from $4,000,000 to $15,000,000.
- Allows service agreement companies to meet their reserve requirement by participating in a risk retention group, if the group:
  - Covers 100 percent of the claims exposure of the company, and
  - Maintains a surplus as regards policyholders of $15,000,000, minimum.

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[11] 15 U.S.C. §§ 3901, et seq. (2016), and part XIX of ch. 627, F.S.

[12] 15 U.S.C. §3902 (2016). Rule 69-O-200.006, F.A.C., requires insurers writing contractual liability insurance to obtain a certificate of authority from OIR prior to doing so. Since risk retention groups from outside of Florida are not issued certificates of authority, the OIR asserts that they cannot offer contractual liability insurance in the state. Florida Office of Insurance Regulation, Agency Analysis of 2017 House Bill 339, p. 5 (Feb. 1, 2017). This rule may conflict with federal preemption regarding risk retention groups and would be resolved by the bill.

[13] Certain risk retention groups organized in Bermuda or the Cayman Islands prior to January 1, 1985, may also transact business in Florida. s. 627.942(9)(c)2., F.S.

[14] FLORIDA OFFICE OF INSURANCE REGULATION, ACTIVE COMPANY SEARCH, http://www.floir.com/CompanySearch/, Select "Risk Retention Group" under "Company Type" (last visited Feb. 17, 2017).

- Removes a prohibition regarding use of an affiliated insurer to meet reserve requirements that applies to service agreement companies offering vehicle protection expenses. This allows them to meet their reserve requirements through risk retention groups, if they wish, and also allows them to purchase contractual liability insurance, for this purpose, from an affiliated insurer.
- Provides specific authority for a lender, finance company, or creditor to cancel a service agreement, if provided for in the agreement, after the agreement has been in place for more than 60 days.

B. SECTION DIRECTORY:

Section 1. Amends s. 634.041, F.S., relating to qualifications for licensure.

Section 2. Amends s. 634.121, F.S., relating to forms, required procedures, provisions.

Section 3. Provides an effective date of July 1, 2017.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   None.

2. Expenditures:

   None.

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Motor vehicle service agreement companies, and their consumers, may benefit from the expanded options for securing required reserves and the increased financial strength required of the entities that may reinsure the service agreement companies.

D. FISCAL COMMENTS:

None.

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

   Not applicable. The bill does not appear to affect county or municipal governments.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided by the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

None.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES

On February 22, 2017, the Insurance & Banking Subcommittee considered the bill, adopted one amendment, and reported the bill favorably with a committee substitute. The amendment made the following revisions to the bill:

- Technical and grammatical changes to the provision of the bill allowing the use of risk retention groups to secure reserve requirements, and
- A new section to the bill was added, which allows a lender, finance company, or creditor to cancel service agreements, if provided for in the agreement.

The staff analysis has been updated to reflect the committee substitute.